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No. 90-1484

In the Supreme Court of the United States

OCTOBER TERM, 1990

UNITED STATES OF AMERICA, PETITIONER

v.

FRED STANTON SMITH, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. The decision below conflicts with the decisions of other courts of appeals that have uniformly construed Section 6012(b) to ensure that tax obligations are borne and fulfilled by the fiduciary who possesses the assets and receives the income of the corporation. While respondents have found no support for a "contract trustee" exception to the statute, they nonetheless argue (Bank Br. 24; Smith Br. 27) that the duties of the liquidating trustee in this case were simply too "ministerial" for him to have to report and pay taxes.

But the statute this case involves does not make distinctions that turn on the breadth of the "discretion" afforded to the "trustee," "receiver" or "assignee." Instead, regardless of the scope of their discretion, the statute requires fiduciaries to report and pay taxes if they have "possession of or hold[] title to all or substantially all the property or business of a corporation,

whether or not such property or business is being operated." 26 U.S.C. 6012(b)(3), 6151. The authority of the persons who have been held responsible for taxes under Section 6012 has been derived from a variety of sources: state statutes (*Hersloff* v. *United States*, 310 F.2d 947 (Ct. Cl.), cert. denied, 373 U.S. 923 (1963); *United States* v. *Loo*, 248 F.2d 765 (9th Cir. 1957), cert. denied, 356 U.S. 928 (1958)); federal statutes (*In re Joplin*, 882 F.2d 1507 (10th Cir. 1989); *In re I.J. Knight Realty Corp.*, 501 F.2d 62 (3d Cir. 1974); *United States* v. *Sampsell*, 266 F.2d 631 (9th Cir. 1959); *Kavanagh* v. *First Nat'l Bank*, 139 F.2d 309 (6th Cir. 1943)); and deeds of assignment or trust (*Louisville Property Co.* v. *Commissioner*, 140 F.2d 547 (6th Cir.), certs. denied, 322 U.S. 754 and 755 (1944); *First Nat'l Bank* v. *United States*, 86 F.2d 938 (10th Cir. 1936); *Northwest Utilities Securities Corp.* v. *Helvering*, 67 F.2d 619 (8th Cir. 1933), cert. denied, 291 U.S. 684 (1934)). But the scope of authority conferred on these fiduciaries—beyond the basic authority to dispose of assets and invest proceeds—was not a point of importance in any of these cases. The relevant similarities between these fiduciaries were (i) that they administered all or substantially all a debtor's property and (ii) that their administration of that property resulted in taxable income. See *In re Knight*, 501 F.2d at 66. If they have possession or title to the debtor's property and if they receive income, they are to report and pay taxes. No more is required for Sections 6012 and 6151 to apply.[1]

2. Respondents also contend that the liquidating trustee is not a "trustee in a case under title 11," as the term is used in Section 6012(b)(3). They argue that the term is meant only to encompass what the Bank calls "statutory trustees" (Bank Br. 17) or the trustee calls

[1] See also L. Sheppard, *When Bankruptcy Courts Take Tax Law Into Their Own Hands*, Tax Notes 158, 161-162 (Apr. 15, 1991) (agreeing that the decision in this case creates a conflict among the circuits).

"Title 11 bankruptcy trustee[s]" (Smith Br. 27). None of the additional language that respondents would engraft onto the statute appears in Section 6012 or its legislative history. Moreover, the trustee has now admitted that he *is* a trustee (Smith Br. 22) and that he was appointed in, and has been serving as a trustee in, a case under Title 11 (*ibid.*).[2] Respondents nonetheless contend that the statutory phrase "a trustee in a case under title 11" is a term of art that excludes liquidating trustees (Bank Br. 17). It is hardly surprising that respondents have found no decisions to support that view. Such a narrow construction of the plain (and broad) language of the statute would quite evidently, and improperly, defeat its comprehensive purpose. See Pet. 11-12. Such a construction would, moreover, conflict with the decisions that have held liquidating trustees to be subject to the statutory requirement. See Pet. 10-11.

Indeed, respondents' efforts to distinguish the liquidating trustee from a "statutory trustee" only highlight the artificiality of the distinction they seek to draw. The Bank finds it necessary to apologize (Bank Br. 21) for the "boilerplate" provisions of the plan that grant the trustee broad powers, arguing that the plan actually eliminates "all discretion" as to the disposition of the debtors' assets and distribution of the proceeds (emphasis

[2] The trustee is in a difficult position here as he tries to slip through what he apparently regards as an intended or unintended loophole between 26 U.S.C. 6012 and 31 U.S.C. 3713. See Pet. 14 n.11. The latter provision imposes liability on persons representing insolvents or their estates who pay any debts before paying a claim of the United States. Trustees "acting under title 11" are excepted from liability. The liquidating trustee must acknowledge that he is acting in "a case under title 11" in order to avoid personal liability under Section 3713. Yet, he must maintain that he is not a "trustee in a case under title 11" in order to argue that he has no responsibility to file returns under Section 6012(b)(3). The very precariousness of his position underlines the interlocking nature of the provisions and Congress's straightforward purpose to impose liability on fiduciaries holding corporate assets.

omitted). In other words, what the plan says is not what it means. While that contention is, of course, implausible on its face, it also fails to distinguish the role performed by the liquidating trustee from that of a "statutory trustee" in a Chapter 7 case. Like the liquidating trustee, the Chapter 7 trustee is charged with reducing the debtor's property to money. 11 U.S.C. 704(1). Like the liquidating trustee, the Chapter 7 trustee must distribute that money in accordance with a specified scheme of priorities. 11 U.S.C. 726. That the "statutory trustee" may have certain additional powers under Title 11 is irrelevant to the reach of Section 6012(b)(3), for the trustee in either situation receives all of the corporate assets for liquidation, and in so doing, generates taxable gain and investment income. Since the corporation in both instances is left bereft of its assets, the Internal Revenue Code imposes the obligation to report income and pay taxes on the fiduciary who holds the assets.[3]

3. The Bank now claims that it was its goal from the outset to subvert the trustee's statutory duty to pay federal income taxes by proposing a plan of liquidation that made no express provision for the payment of taxes (Bank Br. 3, 12-16). The trustee was obviously not sure that the Bank's hidden agenda had been accomplished, for he commenced this adversary proceeding in the bankruptcy court to obtain a determination of whether he should report and pay taxes as 26 U.S.C. 6012(b)(3)

[3] Respondents invoke *In re Alan Wood Steel Co.*, 7 Bankr. 697 (Bankr. E.D. Pa. 1980), as a case addresing the status of fiduciaries who have only "ministerial authority." (Bank Br. 19 & n.21; Smith Br. 29.) As we point out in the petition (at 17 n.13), the disbursing agent in *Alan Wood* did not liquidate assets, but only disbursed proceeds. The focus of the *Alan Wood* decision was that the disbursing agent was acting on behalf of the creditors and that the income received was "income of [the] creditors, not income of the debtor." 7 Bankr. at 701. In our case, by contrast, the court of appeals concluded that the income was income of the debtor but that the fiduciary was free from the statutory obligations to report and pay taxes on that income.

and (4) expressly require.[4] The trustee now asserts, however, that the courts below held that the plan of liquidation positively "does not permit payment of the taxes" (Smith Br. 8) and that it is therefore too late (*id.* at 17-20) for the government to demand his compliance with the tax laws. This argument is not only wrong, it was rejected by the court of appeals.

a. In respondents' view, unless the plan specifically provides that the trustee is to obey the law by filing returns and paying taxes, the trustee is not only free, but is *required*, to ignore those obligations. This Court has quite expressly held, however, that nothing in the Bankruptcy Code grants the trustee "*carte blanche* to ignore nonbankruptcy law." *Midlantic Nat'l Bank* v. *New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 502 (1986).

The plan, in any event, lends no support to respondents' claim. The plan does not state that the debtors, rather than the trustee, will report income and pay taxes on the income generated by the trust.[5] Indeed, to the extent the plan suggests anything regarding the trustee's tax responsibilities, it empowers him "to pay and discharge" all lawful claims against the trust assets and provides that "[a]ll * * * obligations incurred by the Trustee in administering the Trust or in any manner connected, incidental or related thereto, shall be a charge against

[4] See *King* v. *United States*, 379 U.S. 329, 338-339 (1964) (trustee personally liable for failing to seek amendment to plan to pay taxes).

[5] The proponent of a plan is not entitled to remain silent about the tax consequences that it believes will result from liquidation of property under its plan, particularly if it takes the position that the taxes will be borne by persons other than those to whom the debtor's assets are to be transferred. See *In re Haukos Farms, Inc.*, 68 Bankr. 428, 434 (Bankr. D. Minn. 1986). In marked contrast to his current posture, the liquidating trustee at one time viewed the Bank's failure to disclosure its intentions regarding who was to bear the tax burden on income and gains generated by the trust as "a material act of omission" (II C.A. App. Tab J, Tr. 91).

the Trust Property" (Pet. App. 9a). Since the trustee's duties to report and pay taxes under 26 U.S.C. 6012 and 6151 create a valid "charge against the Trust Property," the plan itself contains a valid basis for the trustee to pay the taxes as required by law. In this context, the absence of an IRS objection to the proposed plan is not remarkable.

The Bank also errs in faulting the IRS for failing to file a proof of claim with respect to tax liabilities arising out of the trust administration (Bank Br. 4). Under its longstanding procedures, the IRS files proofs of claim for a debtor's *pre-petition* tax liabilities, as it did in this case. The Internal Revenue Manual provisions set forth at pages B4 through B11 of the Bank's brief in opposition describe the procedures for determining and filing such claims. But the claims for liabilities generated by the liquidating trust are *not* pre-petition claims and they are not governed by those provisions of the Internal Revenue Manual. Indeed, taxes on the post-petition gains and investment income received by the trust were not even due when, on October 10, 1985, the Bank recites that it joined with the trustee in substantially consummating the plan. The IRS thus could not have filed a claim prior to plan consummation for the taxes on post-petition income, and the Bank and trustee could hardly have relied on the lack of such a claim in implementing the plan.

The standard procedure for collection of post-petition taxes is for the trustee to file returns and pay the taxes reported due, as 26 U.S.C. 6012 and 6151 require.[6] Our system of taxation depends upon such self-assessment. *Commissioner* v. *Lane-Wells Co.*, 321 U.S. 219, 223

[6] Congress recognized that procedure in Section 505(b) of the Bankruptcy Code, which provides for prompt audit of a trustee's final return. See 124 Cong. Rec. 32,350, 32,414 (1978) (statement of Rep. Edwards) and 124 Cong. Rec. 33,989, 34,014 (1978) (statement of Sen. DeConcini) ("The prompt audit procedure would not be available with respect to any tax liability as to which any return required to be filed on behalf of the estate is not filed with the proper tax authority.").

(1944). Once the return is filed by the trustee, the IRS may request payment of any amount not paid with the return as an expense of administration. It may also select the return for audit and, if it finds a deficiency, may request payment of the deficiency on the same basis. The fact that the IRS has not yet formalized its claim against the trust for post-petition income in this case reflects only the failure of the trustee to file required returns, not a breakdown in internal procedures on the part of the IRS.[7]

b. That the plan has progressed beyond the point of substantial consummation does not render the case "moot." The concept of "mootness" in bankruptcy cases is that courts decline to grant relief that would require alteration of a confirmed plan when it has "become legally and practically impossible to unwind the consummation of the plan or otherwise restore the status quo before confirmation." *Miami Center Limited Partnership* v. *Bank of New York*, 838 F.2d 1547, 1557 (11th Cir. 1988), cert. denied, 488 U.S. 823 (1988).[8] As the court of appeals recognized in this case, the government does *not* seek to alter the plan, but only to require the trustee to abide by applicable law (Pet. App. 7a):

> The allegation that certain provisions of the * * * Income Tax Code require the liquidating trustee to file and pay income taxes is not an attempt to modify or alter the Plan. The focus of this allegation is that the liquidating trustee failed to act in accordance with the court-approved Plan.

Nor is there any unfairness in the trustee's current predicament. The trustee took steps to resolve any

[7] In the absence of a return the IRS has now tentatively computed Holywell's liability for tax, penalties and interest for the tax year ending July 31, 1986, to be in excess of $33 million.

[8] The question whether this bankruptcy concept of "mootness" should be applied to foreclose appellate review of objections to a plan that were made before plan confirmation is currently pending on petition for a writ of certiorari in *Holywell Corp.* v. *Bank of New York*, No. 90-1551 (filed Apr. 8, 1991).

doubts he harbored about his obligations under the plan and under the Internal Revenue Code. He should, of course, have brought this proceeding *before* he began to distribute trust proceeds. His delay in taking appropriate action, either to escrow or pay the taxes due (and seek a refund, if appropriate), cannot be blamed on the IRS.[9]

c. Respondents claim (with obvious irony) that the result could have been avoided here by greater vigilance on the part of the IRS (Smith Br. 16; Bank Br. 11-13). The statute, however, places this duty of vigilance on the trustee, not the government. Moreover, the court of appeals' decision has the potential for great mischief. The court has sanctioned the creation of an entity that is *free to receive income and ignore the revenue laws.* There can be little doubt that creditors will have every inclination to approve plans, such as the one in this case, that permit them to enhance their distributions at the expense of the public fisc. It is not at all clear how the government can defeat such plans if, as the court of appeals has ruled, liquidating trustees have no legal duty either to *report or pay* tax on their income.

For the foregoing reasons and those stated in the petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

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[9] In his complaint in this action, the trustee alleged that the Bank was responsible for misleading him, and he repeats in his brief in opposition (at 22) that the Bank will ultimately be responsible if the trust is held liable for the taxes. The trustee may also be able to recover the excess payments he made to other claimants. See *Danning* v. *General Motors Acceptance Corp. (In re Jules Meyers Pontiac, Inc.)*, 779 F.2d 480 (9th Cir. 1985); *In re Crotts*, 87 Bankr. 418, 421 (Bankr. E.D. Va. 1988); *In re Kelderman*, 75 Bankr. 69 (Bankr. S.D. Iowa 1987).

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